

DATE: February 24, 1983

Memorandum

TO: Berkeley Board of Adjustments

FROM: Durelle Ali, Commercial Rent Stabilization Coordinator

SUBJECT: FAIR RATE-OF-RETURN STANDARDS

The attached materials are the final recommendations for a fair rate-of-return standard under the Elmwood Commercial Rent Stabilization Ordinance, and the proposed implementing regulations, prepared by consultants Kenneth Baar and Dennis Keating. The February 28, 1983, Board meeting will submit these materials for a 15-day formal public review period prior to considering the adoption of the regulations.

As you may be aware, two public workshops and several Board subcommittee meetings have been held in the promulgation of the regulations. Consultants Baar and Keating have submitted several memoranda outlining various legal and conceptual issues relating to alternative types of fair return standards that have been used under rent controls, the impact of alternative fair return standards on Elmwood rents, and an extensive discussion of the "maintenance of net operating income formula", such as is proposed for your consideration. These materials is not included within this package to avoid innundating you with background material immediately prior to the February 28 hearing. This material, as well as the recordings of the public workshops, will be made available to you upon your request.

In addition, the Consultants conducted a survey of Elmwood property owners and tenants to determine various tenancy conditions. The results of this survey are included in this package.

Attachments

FINAL RECOMMENDATIONS: FAIR RETURN STANDARDS

UNDER ELMWOOD COMMERCIAL RENT CONTROLS

Kenneth Baar and Dennis Keating

February 24, 1983

Prepared for the Berkeley Board of Adjustments

Introduction

This memo is the fourth in a series of reports to the Board of Adjustments on fair return standards under Berkeley's commercial rent stabilization ordinance.^{1/} The first and second reports (November 10, 1982) discussed the pros and cons of the alternate fair return standards that have been used under rent controls and the operation of New York City commercial rent controls, which were in effect between 1945 and 1963. A third report (December 6, 1982), in response to the request and comments of the fair return standards subcommittee of the Board, discussed the various issues associated with the adoption of our recommended "maintenance of net operating income" fair return standard. Under a maintenance of net operating income standard, owners have the right to maintain base period net operating income.^{2/} The third report also included the results of a survey of Elmwood commercial tenants' rental history and owners' rental income and operating costs and financing.^{3/}

Our recommendations address the following issues which were raised in our memoranda to the subcommittee, meetings with the public, and meetings with the Board subcommittee:

- 1) Base Rent Period;
- 2) Fair Return Formula (Maintenance of Net Operating Income);
- 3) Adjustment of Base Rents;
- 4) Ceilings on Rent Adjustments;
- 5) Eligibility Criteria for Rent Adjustments;
- 6) Indexing Net Operating Income for Inflation;
- 7) Banking of Rent Adjustments; and
- 8) Process for Board review of landlord applications for fair return rent adjustments.

In response to the third report, there were owner criticisms that the maintenance of net operating income standard (fully indexed for inflation) increased differences in present rents among owners by giving the largest rent increases to owners with the highest base date net operating incomes. (For example, if there was 10% inflation, an owner with a \$0.70/sq. ft. net operating income would be allowed a \$0.07/sq. ft. increase while an owner with a \$0.40/sq. ft. net operating income would only be allowed a \$0.04/sq. ft. increase. Under this type of standard, in each subsequent year the difference in the rents allowed to each owner would increase because of the widely varying rents in the Elmwood district (ranging from 15¢ to \$1.17 sq. ft. according to our survey).

In response to this criticism, we recommend a system under which uniform annual rent increases per square foot are permitted. A system of this type is feasible under Elmwood commercial rent controls (whereas such a system is not normally feasible under residential rent controls because of the large number of controlled rental units).

^{1/} Review of these previous memoranda is essential to a full understanding of the recommendations contained in this report.

^{2/} "Net operating income" is gross rent minus operating and maintenance expenses (not including debt service).

^{3/} Only 22 of approximately 80 tenants responded to the survey and only 2 of 23 owners responded within the one month survey period.

We also recommend some adjustment of base period rents which are below the average for the regulated district as long as such adjustments do not substantially conflict with the basic purpose of Measure I, which is to "stabilize" existing rents.

This report, in addition to detailing our final recommendations, contains proposed regulations designed to implement the proposed standard. (Appendix B). The final results of our survey (to which approximately 60% of the tenants finally respond) are reported in a supplementary memo.

Summary of Fair Return Recommendations

- 1) A rent adjustment designed to prevent erosion of each owner's net operating income (NOI) should be provided on an annual basis. Said adjustment shall be calculated by multiplying the "mean" (average) base net operating income per square foot for the Elmwood district by the annual increase in the San Francisco-Oakland area Consumer Price Index (C.P.I.). For example, if the mean base NOI is \$0.45/sq. ft. and the inflation rate is 10%, an increase in NOI of \$0.045/sq. ft. would be permitted for all Elmwood commercial properties. The actual adjustment would vary according to each store's square footage.
- 2) The calendar year 1981 should be used as the base period for the purpose of defining fair net operating income.
- 3) Adjustment of the base year rent up to the mean 1981 rent level for the Elmwood district, subject to the restriction that increases pursuant to this provision in any one year shall not exceed 20% of the base year rent.
- 4) Registration of base period rents within a maximum of two months of the adoption of the regulation.
- 5) Annual fair return increases shall not be conditioned on code compliance.
- 6) "Banking"--owners shall retain the right to increases allowed under the fair return regulation in the event the right is not exercised in the year the increase is permitted.

Base Period

It is necessary to choose a common "base" year to determine the average "base" net operating income, even though some Elmwood landlords will not be covered by rent stabilization until their current leases expire. The calendar year 1981 should be used as the base period.

1981 is preferable because it is the most recent year prior to the adoption of Measure I. 1982 is not a possible choice because of the adoption of in June 1982, which affected rents during this year. October 1, 1981 should be the base rent date.

Registration of the Base Period Net Operating Income (NOI)

All Elmwood owners should be required to register their 1981 base NOI with the Board. It is essential that owners register with the Board in order to apply our recommended fair return standard. The registration statement would be relatively simple.

It is the purpose of this report to provide a summary of the results of the study conducted by the author. The study was designed to determine the effect of the independent variable on the dependent variable. The results of the study are presented in the following sections.

The first section of the report is a review of the literature. This section provides a summary of the research that has been conducted in this area. The second section of the report is a description of the study. This section provides a detailed description of the study design, the participants, the independent variable, and the dependent variable.

Results of the Study

The results of the study are presented in this section. The first section of this section is a summary of the results. This section provides a brief overview of the findings of the study. The second section of this section is a detailed description of the results. This section provides a detailed description of the findings of the study, including the results of the statistical analyses.

The third section of this section is a discussion of the results. This section provides a discussion of the findings of the study, including the implications of the results for future research.

The fourth section of this section is a conclusion. This section provides a summary of the findings of the study and a statement of the author's conclusions.

The fifth section of this section is a list of references. This section provides a list of the references that were used in the study.

The sixth section of this section is an appendix. This section provides additional information that is related to the study, including the data that were used in the study and the results of the statistical analyses.

References

The references that were used in the study are listed in this section. The references are listed in alphabetical order of the author's name.

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Appendix

The appendix provides additional information that is related to the study, including the data that were used in the study and the results of the statistical analyses.

Each owner would be required to complete a registration statement which would specify for the year 1981:

1. Tenant;
2. Rent (as of December 1981) (excluding any residential rent);
3. Operating and Maintenance expenses (paid by owner) (not including debt service and unamortized capital improvements); and
4. Square footage--interior floor space with common areas apportioned among actual tenant users.

Each owner should be also required to submit a copy of the 1981 lease.

A sample registration statement is attached to the draft regulation.

This 1981 information should be readily available to landlords (the I.R.S. requires landlords to keep their tax records for a minimum of three years). If the present owner was not the owner in 1981, this information should be obtained from the former owner, if available. If not, the tenant may be able to provide all necessary information except for the owner's operating and maintenance expenses.

Since any adjustments of the base period NOI and the annual fair return increase are based upon the rent per square foot (see explanation below), it is essential that owners be required to register their square footage.

Those owners who will not be covered by Measure I until their current leases expire should still be required to register in 1983 to avoid any future disputes over the 1981 base year NOI.

Owners should be required to file their registration statement within two (2) months (30 days, with an additional 30-day grace period) after the Board's adoption of fair standard regulations and the issuance of the registration statement forms.

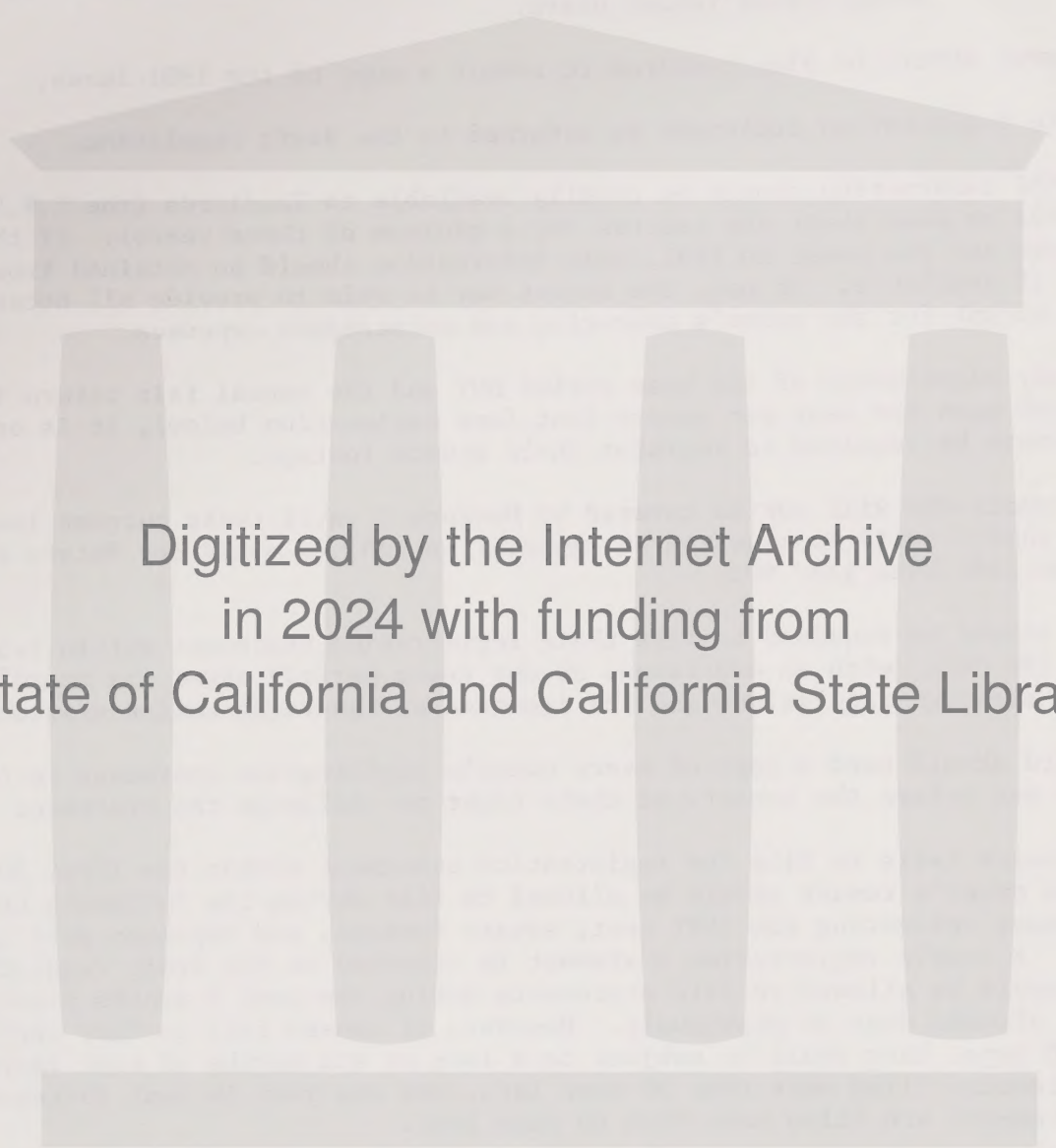
The Board should send a copy of every owner's registration statement to their tenants and inform the tenants of their right to challenge the statement.

If the owner fails to file the registration statement within the first 30 days, then the owner's tenant should be allowed to file during the following three months a statement indicating the 1981 rent, square footage, and expenses paid by the tenant. A sample registration statement is attached to the draft regulation. Owners would be allowed to file statements during the next 2 months also if they had not already done so previously. However, if owners fail to file during the first 30 days, they shall be subject to a loss of six months of rent increases for statements filed more than 30 days late, and one year in rent increases if the statements are filed more than 60 days late.

See
6.10.D
for
mitigation

If the owner and tenant jointly agree in writing on the information contained in the owner's registration statement, then there shall be no challenge.

If the owner and the tenant cannot agree on the measurement square footage, then the Board shall conduct an inspection after prior notice to both the owner and the tenant of the time and date of the inspection, in lieu of an appeal. The owner and tenant shall jointly share the expense of an inspection fee to be determined by the Board. If either party claims "special circumstances," they can appeal the square footage to the Board.



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The Board should conduct hearings under Section 8(c) of Measure I to resolve any conflicts between owners and tenants over the validity of registration statements. Owners should be required to provide documentation to support any challenged registration statements. Any petitioner (owner or tenant) must pay the required petition fee.

Any challenges by tenants in the same building with common ownership should be consolidated. Hearings should be conducted in accordance with Board regulations, with the exception of shorter deadlines.

The Board should review and decide all challenges within one month of the hearing. We anticipate that the most common disputes will concern operating and maintenance expenses and special circumstances concerning square footage. However, the inspection provision should resolve most measurement disputes.

Once the Board resolves all appeals, it shall calculate the 1981 mean (average) NOI per square foot based upon the registration statements and other available information. If both an owner and tenant fail to file a statement, that store will not be included in that average calculation. Any statements filed after these deadlines shall not be used to revise the 1981 base mean NOI per square foot. If only a tenant files a statement, then the Board may presume that their owner's operating and maintenance costs have the same costs per square foot as that of the statements actually filed by landlords. However, the Board should not calculate the 1981 mean NOI until at least 50 percent of the regulated units are registered so that it is sufficiently representative.

In calculating the mean NOI, the Board shall not include any base rent adjustments allowable under the provision allowing for an adjustment of some base rents (see below).

Owners not covered by Measure I until their current leases expire who fail to file a timely registration statement should not be allowed to charge tenants retroactively a fair return rent increase to which they would be otherwise entitled for the period during which they failed to file (see "penalty" section).

Owners who are covered should not be entitled to apply for or receive a fair return rent increase (or base rent adjustment) unless they have filed a valid registration statement (again, see "penalty" section).

Adjustment of "Base" Rents

Under Section 5(b)(iii) of Measure I, owners with fixed rent leases who have not increased their rents in the year prior to June 1982, are allowed a 5 percent rent increase for each year that rents have not been increased. (For example, if rents have not been increased since 1977, a 20 percent rent increase would be allowed.) This provision excludes owners who have made even very low increases in 1981-1982, from obtaining increases for prior years during which they may not have increased the rent. Also, because it is a flat percentage adjustment, it gives the smallest increases to owners with the lowest rents.

Due to the long-term nature of commercial tenancies and leases, wide disparity among Elmwood rents results from differing patterns of leases, ownership, and related factors. The 1981 base rent per square foot should be increased if it is below the 1981 mean rent per square foot in Elmwood.

Our survey indicated that the 1981 mean rent per square foot was \$0.56.

The rent was below that mean for 18 of the 31 respondents. Only after completion of the filing and any necessary review of challenged registration statements could the Board determine what this figure would actually be. Our survey does suggest that, after any other adjustments allowed by Measure I, many owners would be entitled to a base rent adjustment. Some owners would be entitled to very substantial rent increases. Those owners whose 1981 rents exceeded the mean would not, of course, be entitled to any base rent adjustment, with the exception of any adjustment otherwise provided by the Ordinance.

This base rent adjustment would be allowed only after the filing of an application by an owner after the Board issues its calculation of the 1981 mean base NOI per square foot. The tenant could challenge the application if the tenant believes that the owner's claim for an adjustment is not valid because of inaccuracies in the registration statement.

In order to protect tenants against abnormally high base rent adjustments, in accordance with the view of the Subcommittee, it is recommended that the Board limit such an increase to 20 percent of the 1981 base rent annually. If any owner is entitled to an additional increase, the remainder should be phased in during succeeding year(s) (see example below).

Annual Rent Increases

As indicated in our previous reports, Measure I only allows for a passthrough of operating income. We believe that, in order to meet the fair return requirements of the California Supreme Court as set forth in Birkenfeld v. Berkeley required by Measure I, the Board's regulations should allow for annual maintenance of the mean base net operating income. The fair return standard should also be understandable and as simple as possible to administer.

Therefore, we recommend that, in addition to the operating cost passthrough, already allowed under Section 5(c), owners be permitted an additional annual rent adjustment equal to the mean base net operating income/square foot for the Elmwood district multiplied by the inflation rate. Our survey indicated a mean 1981 rent/sq. ft. of \$0.56. Assuming that NOI is equal to 80% of gross rent, the mean NOI/sq. ft. would be \$0.45/sq. ft. Therefore, 10% annual inflation would justify a \$0.045/sq. ft. rent increase. The actual annual increase would vary according to the size of the store (our survey indicated that the size of stores ranged from 220 to 4,121 square feet).

Since no fair return adjustments have been allowed since Measure I was enacted in June 1982, it is recommended that the first annual adjustment take into account the increase in the C.P.I. from June 1982 to the date when fair return adjustments are first permitted. It is recommended that the Board use one single C.P.I. figure so that there is no discrimination in adjustments due to fluctuations in the bi-monthly C.P.I. If feasible, the Board should use the December C.P.I. beginning in December 1983. This would allow owners to apply for and receive annual fair return adjustments every January. In December 1982, the C.P.I. did not increase at all; in comparison, in December 1981, it increased by 15.3%.

Since Measure I is already based in part on the San Francisco-Oakland C.P.I. (Section 4(f)), it is recommended that this be used to index mean base NOI. As previously indicated, in January 1983, the U.S. Bureau of Labor Statistics revised the C.P.I. (to correct for overweighting of homebuyer's mortgage costs).

In accordance with the view of the Subcommittee, we do not recommend that a ceiling be imposed on the indexing of the mean base NOI. If the C.P.I. increases as of the adjustment date, then the mean base NOI will be fully adjusted for inflation.

We do not recommend that owners' eligibility for a fair return rent increase be conditioned on building code compliance until the Board has more information concerning this issue. The Board needs to know which codes apply to Elmwood's commercial buildings, to what extent serious violations (attributable to owners) currently exist, and to what extent the conditioning of eligibility on this basis would affect Elmwood owners and tenants.

The following examples are designed to illustrate the combined effects of the base rent adjustment and annual fair return rent increase standards. (These increases are in addition to operating cost passthroughs.)

Assumptions:

1. Mean base 1981 rent for Elmwood district - \$0.56/sq.ft./month
2. Mean monthly NOI/sq.ft. = \$0.45
3. Increase in C.P.I. = 10%
4. Unit area = 500 sq.ft.

Hypothetical #1:

- Rent = \$1.00/sq.ft. (\$500)
- Increase permitted-
 - a. annual rent adjustment-
 $10\% \times \$0.45 \times 500 = \$22.50/\text{month}$
 - b. base rent adjustment-
none (because base rent exceeds mean)
 - c. total increase permitted =
\$22.50/month

Hypothetical #2:

- Rent = \$0.50/sq.ft. (\$250)
- Increase permitted-
 - a. annual rent adjustment-
 $10\% \times \$0.45 \times 500 = \$22.50/\text{month}$
 - b. base rent adjustment-
\$0.06/sq.ft. (difference between mean and rent charged (\$0.56-\$0.50))
 $\$0.06 \times 500 = \$30.00/\text{month}$ (=12% increase)
 - c. total increase permitted (a&b) - \$52.50/month

Hypothetical #3:

- Rent - \$0.36/sq.ft. (\$180)
- Increase permitted -
 - a. annual rent adjustment -
 $10\% \times \$0.45 \times 500 = \underline{\$22.50}$
 - b. base rent adjustment-
\$0.20/sq.ft. (difference between mean rent and rent charged
\$0.56-\$0.36)
 $\$0.20 \times 500 = \$100/\text{month}$ (= 56% increase)

This increase is subject to 20% ceiling on annual rent adjustment under this provision. In this case the annual ceiling is \$36 ($.20 \times \180).

The balance may be phased in over the two subsequent years (\$36 in the second year and \$28 in the third year).

c. Total rent increase permitted (a&b) = ⁵\$48.50/month

As these three examples indicate, if the store size is identical, rent increases will vary depending upon whether the owner is eligible for an initial base rent adjustment and, if so, whether the base rent adjustment ceiling (20%) applied.

In all three examples, assuming that 20% of the rent equals operating and maintenance expenses paid by the owner, if the costs increase by 10%, then the owner is already entitled to pass on to the tenant this increased expense in order to maintain net operating income.

The actual rent increase will vary according to the size of the store (unit area). Using the same assumptions but applying the rent increase to larger and smaller stores, the results would be:

Hypotheticals #1-2-3: (500 sq.ft. x \$0.45 x 10%) = \$22.50/month

Hypothetical #4: (unit area - 1,000 sq. ft. x \$0.45 x 10%) = \$45/month

Hypothetical #5: (unit area - 250 sq.ft. x \$0.45 x 10%) = \$11.25/month

This standard is objective, easy to understand, and simple to administer.

Each December, after the issuance of the San Francisco-Oakland C.P.I., the Board would issue an order indicating the uniform fair return increase. Owners could then apply for the increase. Unless a tenant disputed the owner's right to the increase, the landlord would be automatically entitled to any allowable increase. Tenants could challenge an owner's petition on the ground that the owner has not filed a registration statement or that there are changed circumstances (e.g. reduction of rented space) or any other relevant factors to be determined by the Board.

The Board should be able to review owners' petitions within 30 days. The owner would be entitled to charge the tenant effective as of the date of the filing of the petition, apportioning it over the remainder of the year, after giving the tenant the required 30 days notice of the rent increase once it is approved by the Board.

The following schedule, if feasible, is recommended for the first annual fair return increases and base rent adjustments.

1983

- | | | |
|------------------|---|---|
| April | - | Board adopts fair return regulations |
| May-August | - | Owners (and tenants) must file registration statements |
| June - September | - | Tenants can file challenges to owner registration statements
and vice-versa <i>Tenants can also file own reqs.</i> |
| July-December | - | Board reviews and decides all tenant challenges |
| December | - | U.S. Bureau of Labor Statistics issues December 1983 C.P.I. |
| | - | Board calculates mean base NOI and announces 1984 fair return rent increases (June 1982-December 1983) |
| | - | Owners can apply for fair return rent increases and eligible owners can also apply for base rent adjustment. |

1984

January - Owners can charge first annual fair return rent increases.

Banking of Fair Return Rent Adjustments

The subcommittee favored the inclusion of a "banking" provision. If an owner does not take a permissible rent increase within a particular year, that owner shall have the right to take that increase in future years.

The principal argument for banking is that it gives landlords the option of not raising rents in a particular year, without losing the right to the increase in future years. Without such a right, owners would be penalized for not raising rents as frequently as permitted. The argument against such a provision is that it may cause future confusion or lack of knowledge as to legal rent levels. Also, it may lead to very substantial rent increases in future years. One possibility is to place a time limit on such increases. For example, all increases must be taken within three to five years of the time that they are originally permitted.

It is recommended that in instances where rent increases allowed under current leases, exempt from Measure I until their expiration, are less than the increases allowed under the annual rent increase provision of the fair return regulations, the owner should be allowed to "bank" the difference between the two increases. For example, if a lease restricts rent increases to \$0.02/sq.ft. and a \$0.05/sq.ft. increase is allowed under the annual rent adjustment provision, the owner would be allowed to "bank" a \$0.03/sq.ft. increase until the termination of the lease.

Failure to register should result in a loss of the right to "banking" of any increases permitted during the period in which the owner failed to register. Owners should also be required to notify tenants of the owner's election to bank rent increases (with loss of the banked rent increase as a penalty for non-disclosure).

FAIR RETURN REGULATIONS UNDER ELMWOOD COMMERCIAL RENT CONTROLS

Section 600 - Purpose

The purpose of these regulations is to provide landlords with a fair return, by permitting annual increases in net operating income over the 1981 base period and by permitting landlords who charge below average rents for the Elmwood district to raise their rents to the mean for the regulated commercial district.

Section 605 - Definitions

- (a) Consumer Price Index - The Consumer Price Index for the San Francisco-Oakland area - all items.
- (b) Base year - 1981
- (c) Square footage - total gross rented interior commercial floor area, unless determined to be otherwise by the Board due to special circumstances in accordance with the intent of the parties and the purpose of the ordinance. Common space in buildings occupied by more than one tenant shall be apportioned equally among actual tenant users.
- (d) Net operating income - Gross rent minus maintenance and operating expenses (as defined in Section 530) and amortized capital improvements (as defined in Section 531), exclusive of debt service.

Section 610 - Registration Statement

- (a) All landlords shall be required to complete and return registration statements on a form provided by the Board (attached as Appendix A of this regulation). Said forms shall provide information as to: ownership, tenant, rent, square footage, operating and maintenance expenses, and any other information required by the Board as to the base year.
- (b) All landlords shall file registration statements no later than 30 days after mailing by the Board of this notice of registration requirement and a copy of the registration form. All landlords shall have an additional 30 days to file the registration statement without penalty.
- (c) If any landlords fail to complete and return this form within the initial 30-day registration period, their tenants may file a registration statement regarding the controlled unit on a form provided by the Board (attached as Appendix B of this regulation).
- (d) Landlords who file registration statements more than 60 days after the date specified in (b) shall pay a late processing fee of \$20 per unit and shall be subject to the following sanctions:
 - i) where the registration statement is filed on or before the ninetieth (90th) day after the date specified in sub-section (b) the effective date of any rent increase to which such landlord is entitled under Sections 600 et. seq. will be delayed six months from the date on which such increase would otherwise be operative;
 - ii) where the registration statement is filed more than ninety days from the date specified in sub-section (b), the effective

date of any rent increase to which a landlord is entitled under sub-sections 600 et. seq. of these regulations shall be delayed one year from the date on which such increase would otherwise be operative.

- (e) The Board shall provide tenants a copy of registration statements filed by their landlord within 10 days of receipt of the statement. Copies of registration statements shall be sent by both regular and certified mail, and shall include a notification to landlords and tenants of their right to file challenges, and that they must file such challenges within 30 days of the date of mailing of the copy of the registration statement.
- (f) Landlords and tenants shall file written challenges to previously filed registration statements on a form provided by the Board indicating the basis for the challenge. Any party (landlord or tenant) challenging a registration statement shall pay the petition filing fee of \$100 for the first unit and \$20 for each additional unit in the same building. For purposes of this section, a registration statement filed by a landlord after the tenant has filed a statement shall be deemed such a challenge and shall be subject to a petition fee in lieu of a late processing fee.
- (g) The Board shall conduct hearings on all challenges to registration statements in accordance with Section 852-859.. For purposes of the hearings conducted to resolve disputes regarding the contents of registration statements and petitions for rent increases under Section 613 only the applicable time limits under Sections 852 and 858 shall be as follows:

- i) The adverse party's time to respond to the challenge shall be 15 days from the date of the mailing of the petition;
 - ii) The case shall be set for a hearing within 15 days of the date the response is received or the time to respond has expired and the parties shall be afforded seven days' notice of the hearing; (see Section 8)
 - iii) The Board shall render its decision within 15 days of the date of the hearing. These deadlines may be extended for good cause by the Board.
- (h) If a landlord and tenant cannot agree on the measurement of the square footage during the registration period and either or both parties so request, the Board shall conduct an inspection of the disputed unit, as soon as possible. The Board shall notify both the landlord and tenant at least three (3) days in advance of the inspection and of their right to be present during the inspection. If the Board conducts an inspection, the landlord and the tenant shall jointly pay an inspection fee to be determined by the Board, and shall be bound by the determination of such an inspector. The inspection procedure is in lieu of an appeal and determination by the Board.

Section 611 - Adjustment of Base Rent

- (a) Rents for units which are below the mean base rent per square foot as of October 1, 1981, may be raised to the mean base rent per square foot for the regulated district as calculated by the Board as of October 1, 1981, subject to the restriction that no increase in any one year shall exceed 20% of the base rent for that unit.
- (b) Base rent for the purposes of this section shall be the rent in effect as of October 1, 1981.
- (c) Calculation of the mean base rent per square foot and the mean base net operating income per square foot shall be made by the Board no later than 30 days after the final resolution of any and all challenges to registration statements. Said calculation shall be based on the information contained in the registration statements and any other available data, and shall be published by the Board.
- (d) However, the Board shall not calculate the mean base rent and net operating income per square foot until at least 50 per cent of all units in the regulated district are registered.
- (e) The Board shall publish the mean base net operating income as soon as possible after its calculation.

Section 612 - Annual Rent Adjustment

- (a) Effective the date the mean net operating income per square foot is adopted in accordance with Section 611, owners shall be permitted on an annual basis to obtain rent increases designed to allow the mean net operating income per square foot for the district to increase by the inflation rate (as measured by the Consumer Price Index for December or other appropriate month of each year).
- (b) Said increase shall be calculated according to the following formula:

$$A_n = \left(M + \sum A_{1,2,3 \dots (n-1)} \right) \times \left(\frac{I_n - I_{(n-1)}}{I_{(n-1)}} \right)$$

Where A_n = annual adjustment in year n

$\sum A_{1,2,3 \dots (n-1)}$ = sum of all previous annual adjustments

n = the year in which the calculation is made; n=1 on the date when the Board of Adjustments adopts the calculation of mean net operating income per square foot for the Elmwood Commercial District. N will equal 2 on the first anniversary of the adoption date, n=3 on the second anniversary and so forth; n=0 on June 1982, the date of adoption of the Ordinance.

M = mean net operating income per square foot of Elmwood District commercial properties - projected date of adoption by Board is 12/83.

I_n = CPI for year n. If the Board of Adjustments set a value for M (mean n.o.i./square foot) on or shortly after 12/83, the December CPI will be used. Otherwise it will be the month of the anniversary of the CPI published immediately prior to Board action.

$(I_n - I_{(n-1)}) =$ Positive growth in CPI from CPI from previous year. An exception occurs when $n=1$ and $n-1=0$, when the growth in CPI is measured over the period from adoption of the Ordinance to December 1983, or whenever the Board sets a value of N.

$$(I_n - I_{(n-1)}) \geq 0. \text{ Where } I_n - I_{(n-1)} < 0, \text{ let } I_n = I_{(n-1)}$$

Translated into more easily applied notation, the formula for the annual adjustment can be represented as follows:

The first annual adjustment (expected to occur on 12/83, when the Board of Adjustments adopts the mean noi/square feet) will be equivalent to

$$(\text{Mean noi/sq ft}) \times \left(\frac{\text{Dec 1983 CPI} - \text{June 1982 CPI}}{\text{June 1982 CPI}} \right)$$

$$\text{subject to the condition that } \left(\frac{\text{December 1983 CPI} - \text{June 1982 CPI}}{\text{June 1982 CPI}} \right) \geq 0.$$

In subsequent years, the annual adjustment will be equivalent to

$$\left(\frac{\text{Mean noi} + \text{all previous year adjustments}}{\text{square foot}} \right) \times \left(\frac{\text{Current year CPI} - \text{Prior Year CPI}}{\text{Prior year CPI}} \right)$$

Where a landlord chooses to "bank" or defer application of the annual adjustment, the formula will be used to calculate successively each year's increase.

Section 613 - Petitions for Rent Increases

- (a) No petition for a rent increase under the fair return regulations may be made until a unit is properly registered in accordance with these regulations. Landlords may register at any time, but any registration statement received after the deadline contained in Section 610 shall not be used to calculate the mean base net operating income per square foot.
- (b) Petitions for rent increases shall be conducted in accordance with Section 610(g).
- (c) Grounds for rejection of petitions for increases in whole or in part shall include but not be limited to: an owner's violation of the ordinance, changed circumstances warranting modification of the square footage on which the increase is to be calculated, conformance with the purpose of the rent stabilization ordinance.
- (d) The right to any increases granted pursuant to this section shall be retroactive to the date of the filing of the petition, subject to the provisions of the California Civil Code. In order to effectuate the purposes of this section, the Board shall allow rents to be adjusted in a manner which permits the owner rent increases for the period between the date of the filing of a petition and the date in which the increase takes effect.

Section 614 - "Banking" of the Right to Rent Increases

- (a) The purpose of this section is to enable a landlord to delay maximum allowable increases in rent under these regulations, without a loss in future rents that may be charged for the unit.
- (b) In the event an increase permitted under the fair return regulations is not taken by the landlord as a result of choice or an existing lease provision, the difference between the actual increase and fair return increase that would have been permitted may be accumulated for the purpose of calculating future permitted rent levels. (For example, if \$0.05 increase is allowed in Year #1 and \$0.04 increase is allowed in year #2, the owner who does not obtain a \$0.05 increase in Year #1, shall be permitted a \$0.09 increase in Year #2.)
- (c) The "banking" of rent increase rights under this section shall be subject to the other sections of this regulation and shall be conditioned on compliance with the registration requirement for the entire year for which the right to any increase is to be "banked."
- (d) The Board shall send a letter to all landlords and tenants explaining the operation of the "banking" provisions.
- (e) All landlords shall notify new tenants in writing of the landlord's right, if any, to bank rent increases accumulated under this section prior to the new tenancy. A landlord who fails to so notify a new tenant shall forfeit the right to apply bank rent increases to the new tenant's rent.

APPENDIX A

Elmwood Owner's Registration Statement (Draft)

A. Owner (Current)

Name

Address

Managing Agent (if any)

Telephone

()

1981 Owner (if different
from current owner)

Name

Address

B. Tenant (1981)

Name

Address

C. Rent (monthly)

October 1, 1981

\$

D. Operating and Maintenance Expenses (1981)

(N.B. Do not include debt service or unamortized capital improvements)

Please itemize. Only list expenses paid by owner in 1981.

a) Property Taxes \$

b) Building Maintenance \$

c) Building Repairs \$

d) Insurance \$

e) Utilities

Water \$

Sewer \$

Gas \$

f) Garbage \$

g) Other (please explain) \$ _____
Total (1981) \$ _____
Total ÷ 12 months \$ _____/month

E. Square Footage

(N.B. Only list space rented to tenant as of October 1, 1981)

_____ square feet

F. Lease

(Attach copy of 1981 lease)

G. Comments

(Owner's Signature)

(Date)

(Tenant's Signature)

(Date)

APPENDIX B

Elmwood Tenant's Registration Statement (Draft)

A. Tenant (Current)

Name _____

Address _____

Telephone _____

1981 Tenant (if different
from current tenant)

Name _____

Address _____

B. Owner

Name _____

Address _____

Telephone () _____

C. Rent (monthly)

October 1, 1981

\$ _____

D. Operating and Maintenance Expenses 1981

Please Itemize. Only list expenses paid by tenant in 1981.

a) Property Taxes \$ _____

b) Building Maintenance \$ _____

c) Building Repairs \$ _____

d) Insurance \$ _____

e) Utilities

Water \$ _____

Sewer \$ _____

Gas \$ _____

f) Garbage \$ _____

g) Other (Please explain) \$ _____

Total (1981)

\$ _____

Total ÷

\$ _____/month

E. Square Footage

(NIB. Only list space rented as of October 1, 1981.)

F. Lease

(Attach copy of 1981 Lease)

G. Comments

Tenant's Signature

Date

ELMWOOD LANDLORD AND TENANT SURVEY

Supplementary Report to Berkeley
Board of Adjustments

BY

KENNETH BAAR AND DENNIS KEATING

February 14, 1983

On October 1, 1982, a questionnaire was sent to each Elmwood commercial property owner requesting information by November 5, 1982 about: purchase price, rent levels 1978 - 1982, 1980 and 1981 expenses and income, financing, and capital improvements. A letter accompanying the survey form requested that as much information as is readily available be supplied, in the event that not all of the information requested was easily available. Anonymity for all respondents was guaranteed.

In early November landlords were contacted by telephone in an attempt to gain their cooperation, since none of the survey forms had been returned. Only two of the 23 owners completed and returned the questionnaire by December 3, 1982.

A survey questionnaire was also sent to each tenant, requesting information about: original date of tenancy, commencement and termination of the current lease, rent lvevel 1978-present, expenses paid by owner and tenant, capital improvements, and changes of ownership of the property. Twenty-two of approximately 80 tenants completed and returned the questionnaires by December 3, 1982. The results of the survey were reported in our December 6, 1982 memorandum.

Additional responses were requested. By January 21, 1983 another 28 tenants had responded for a total of 50 (approximately 60%). Only one other landlord responded. The three landlord responses (13%) were incomplete and were not tabulated.

The overall results of the tenant survey are reported. Total responses to particular responses vary because not all tenants responded to every question.

Table 1

Elmwood Leases

<u>Original Date of Tenancy</u>	<u>Tenants</u>
1940 or earlier	3
1941 - 1949	2
1950 - 1959	2
1960 - 1969	11
1970 - 1974	6
1975 - 1979	9
1980 - 1981	8
1982	5

Current Lease

Commencement

Tenants

1964	1
1977	5
1978	2
1979	4
1980	4
1981	8
1982	8

Expiration

1982	4
1983	8
1984	9
1985	3
1986	1
1987	3
1990	3
1991	2
1992	1

Term

Month-to-month	7
Two years	6
Three years	4
Four years	2
Five years	8
Nine	5
Ten years or more	3

How Rent Set

Fixed Rent	21
Consumer Price Index Escalator	11
Property Tax Escalator	4

Table 2

Responsibility for Expenses

<u>Expenses</u>	<u>Paid by Owner</u>	<u>Paid by Tenant</u>	<u>Shared</u>
Electricity	2	40	
Gas	2	38	
Water	9	32	
Sewer Treatment and Maintenance	9	26	
Trash	5	37	
Insurance (Fire/Liability)	15	24	
Operating, Maintenance and Repairs	12	21	5
Property Taxes	18	16	1

Table 3

Mean Rents (per square foot) (1980-82)

<u>1980</u>	<u>1981</u>	<u>1982</u>
\$0.51	\$0.56	\$0.69

This data is based upon 31 responses. The stores ranged in size from 220 to 4,121 square feet. In 1981, 18 of the 31 tenants' rent was below the mean. In 1981 rents per square foot ranged from a low of \$0.15 to a high of \$1.17.

In 1982 rents per square foot ranged from a low of \$0.15 to a high of \$1.32. The following compares our survey with that conducted by Blayney-Dyatt for the City of Berkeley.

Table 4

<u>Baar - Keating</u> (41 respondents)		<u>Blayney - Dyatt</u>	
<u>% Respondents</u>		<u>% Respondents</u>	<u>Rent/Square Foot</u>
22		-	\$0.50 or less
56		28	0.75 or less
27		25	0.76 - \$1.00
17		10	1.01 - \$1.50
0		3	1.50 - or more

Rent Increases

Twenty-eight tenants provided information concerning rent increases between 1978 and 1981. Twenty reported rent increases, cumultatively averaging 39.1%. Including the eight tenants who reported no rent increases, the cumulative average rent increase was 27.9%. During this same period (January 1978 - December 1981) the San Francisco - Oakland Comsumer Price Index (CPI) increased by 45.1%.

Table 5

Cumulative Average Rent Increases (1978 - 1981)

<u>Number of Units</u>	<u>Cumulative Rent Increase %</u>
12	0 - 9.9
2	10 - 19.9
6	20 - 39.9
5	40 - 59.9
1	60 - 79.9
0	80 - 99.0
2	100 - or more

Table 1

Table 1: Data for Figure 1

Year	Value	Value
1970	10	10
1975	20	20
1980	30	30
1985	40	40
1990	50	50

Table 2

Table 2: Data for Figure 2

The following table shows the data for Figure 2, which is a line graph showing the relationship between the year and the value of the variable. The data is presented in two columns: Year and Value. The values are calculated based on the formula: $Value = 10 \times Year$.

Table 3

Table 3: Data for Figure 3

Year	Value	Value
1970	10	10
1975	20	20
1980	30	30
1985	40	40
1990	50	50

The following table indicates the average percentage rent increases for those units which reported rent increases between 1979 and 1981:

Table 6

Average Percentage Rent Increases

(only for units reporting
rent increases) 1979-1981)

	<u>1979</u>	<u>1980</u>	<u>1981</u>
Number of Units reporting rent increase	9	15	21
Unweighted average percentage rent increase	11%*	16.8%	17.5%
Percent Increase (San Francisco - Oakland CPI - All Items)	8.5%	15.2%	12.8%

*Two tenants reported decreases averaging 4.6%.

The survey also indicated that 23 tenants received rent increases averaging 41.3% in 1982. If three extraordinarily high rent increases in excess of 100% are excluded, the remaining 20 averaged 18.8%. This data only indicates those rent increases up to the date of passage of Measure I in June 1982.

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